In the Supreme Court of the United States

OCTOBER TERM, 1978

Supreme Court, U. S.
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No. 77-1134

UNITED STATES OF AMERICA,

Appellee,

- vs -

STATE OF MONTANA; DEPARTMENT OF REVENUE OF THE STATE OF MONTANA; and W. A. GROFF, Director of Revenue of and for the State of Montana, and his successors in office,

Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

BRIEF OF APPELLANTS

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Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

BRIEF OF APPELLANTS

Opinion Below

The judgment and opinion of the three judge Federal District Court for the District of Montana are reported at 437 F.Supp. 354 and are set forth in the separate Appendix to Jurisdictional Statement, (J.S. App.) commencing respectively at pages 1 and 5.

Jurisdiction

Jurisdiction of this Court was invoked pursuant to 28 U.S.C., Section 1253, this being an appeal from a

final declaratory judgment and decree of permanent injunction granted in a civil suit in which the United States was Plaintiff and which was heard and determined by a Federal District Court of three judges and in which the Montana Contractor's Gross Receipts Tax (Chapter 35, Title 84, Revised Codes of Montana) was declared unconstitutional and enforcement of the Act was enjoined. Taxes collected under the Act since mid-1971 were ordered repaid. The action was commenced below by the United States pursuant to Title 28, Sections 1345, 2201, 2281 and 2284.

The judgment below was dated October 17, 1977, and was filed and entered on October 18, 1977, in the United States District Court for the District of Montana, Helena Division, in Civil Action No. 1989. No order was made respecting any rehearing. Timely Notice of Appeal, dated December 15, 1977, was filed in the foregoing District Court on December 15, 1977.

The statutory provisions believed to confer jurisdiction of this appeal on this Court are Title 28, U.S.C., Sections 1253, 2281 and 2284. Probable jurisdiction was noted in this case on May 22, 1978.

Statute Involved

The validity of Montana's Contractors' Gross Receipts Tax (the Act) is involved in that the judgment below held that the Act, Chapter 35, Title 84, officially published in Volume 5, Part 2 of the Revised Codes of Montana, as amended, is in violation of the Supremacy Clause, Article VI, Clause 2, of the United States Constitution and is, therefore,

unconstitutional and void as to the United States of America, its contractors, subcontractors and those with whom it deals. The text of Chapter 35 is lengthy and is set forth verbatim, J.S. App. 38, *et seq.*

Nature of the Montana Act Which was Declared Unconstitutional

The Montana Act levies an initial 1% tax upon the gross receipts of "public contractors" defined to include all persons who perform contracts for the State of Montana, its subdivisions (e.g., counties, municipalities, school districts, special improvement districts etc.) and the United States Government. No gross receipts tax is levied under the Act upon "private contractors" — those who perform construction contracts for private citizens. The Act contains provisions for refunds and credits: public contractors who produce proof of payment of Montana personal property taxes receive dollar-for-dollar refunds of such taxes from the gross receipts taxes paid; the balance of the gross receipt tax may be claimed as a credit against Montana's personal income and corporate license taxes. By virtue of such credits the effective rate of the 1% gross receipts tax is reduced to approximately one half of one percent. The tax is levied on the contractor, not on any governmental unit. The Federal government has nothing to do with collecting, withholding or remitting the tax.

Constitutionality of Montana Act was Twice Construed by the Montana Supreme Court During Period When Federal Court Action in this Case was Stayed for that Purpose

On April 2, 1971, Peter Kiewit Sons' Co. filed a suit in Lewis and Clark County, Montana challenging the constitutionality of the Act here in question. This state case proceeded through the Montana trial and appellate courts and is reported as *Kiewit Sons' -vs- St. Bd. of Equalization*, 161 Mont. 140, 505 P.2d 102 (1973), and can be conveniently referred to here as "Kiewit #1". It appears in the J.S. App., commencing page 105.

On April 12, 1971, the United States filed a federal court complaint identical to the state court *Kiewit #1* litigation in the Federal District Court of Montana, Cause No. 1989, Helena Division. A three judge Court was impaneled. On May 10, 1971, Montana filed its answer; and on May 24, 1971, the parties stipulated (J.S. App. 49) and the court made an order continuing the federal case without date "pending the resolution in the state courts or appeals therefrom of the (Kiewit #1) case." (J.S. App. 50)

During the federal stay period, described above, the Montana Supreme Court also decided *Kiewit #2*, 166 Mont. 260, 531 P.2d 1327 (1975), holding that *Kiewit #1* was *res judicata* as to the constitutional challenges to the Act and additionally finding that the Act is a valid revenue raising measure.

The United States controlled the state court *Kiewit* litigation. It directed the filing of the cases; paid the costs of litigation; was the real party in interest; directed the appeals to the Montana Supreme Court and to the United States Supreme Court. Notice of Appeal to the Supreme Court of the United States was filed in *Kiewit #1* pursuant to 28 U.S.C., 1257 (2), but was abandoned by Kiewit in

August, 1973 at the direction of the U. S. Solicitor General, Erwin N. Griswold. (See Agreed Fact 12, J.S. App. 86)

After the state court litigation was concluded and the U. S. Supreme Court appeal was dismissed, Montana moved for Summary Judgment (J.S. App. 63) in the federal litigation under the rules of *England -vs- Medical Examiners*, 375 U.S. 411 and *Drummond -vs- U.S.*, 324 U.S. 316 on grounds that the United States controlled the state court litigation and had elected to fully litigate the case in the state courts and could not now return to the federal court to relitigate its claims. Also, the doctrines of *res adjudicata* and collateral estoppel were specified in support of such Motion. On November 8, 1974, the Federal District Court denied the motion (J.S. App. 65-75), and the constitutional issues were again presented by the United States to the Federal Court resulting in the declaration of unconstitutionality and the injunction recited under "Jurisdiction", above.

Questions Presented

1. Whether a one-half of one percent state gross receipts tax on contractors performing construction contracts for the State (and subdivisions) and Federal Governments violated the Supremacy Clause and the rule of *Phillips Chemical Co. -vs- Dumas School District*, 361 U.S. 376 (1960) because the revenue from the tax is a benefit to the State but not to the Federal Government.

2. Would not an interpretation of the *Phillips* rule outlawing the Montana Act under "1" next above render *any* state tax on contractors or suppliers for

both state and federal governments void and "overrule", sub silentio, prior landmark decisions?[1]

3. Under the rule in *United States -vs- County of Fresno*, 429 U.S. 452 (1977) requiring that the state tax be imposed equally on the federal contractors and also on other similarly situated constituents in Montana, did not the contractors performing public contracts for the Montana cities, school districts, special improvement and irrigation districts, etc., constitute such a class; and was not the treatment of these non-federal constituents precisely like that of contractors working for the federal government so as to render the tax non-discriminatory?

4. Where the inherent nature of the Act requires classification of private citizens into taxpayers and non-taxpayers, did not the lower court err in eschewing any consideration of equal protection standards in testing for discrimination — even though it went on to find violation of the Equal Protection Clause?

5. Was it not error for the lower court to equate the Federal Government to the status of a taxpayer and test the classification of taxpayer and non-taxpayer under Supremacy standards; and would not such a Supremacy test invariably render state taxes void even when they clearly meet Equal Protection standards?

6. In this taxation field involving questions of "inter-governmental tax immunity" (*Phillips Chemical* at 361 U.S. 385) heavily involving present and future tax programs of the several states, should

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[1] *James -vs- Dravo Contracting*, 320 U.S. 134 (1937); *Silas Mason Co. -vs- Tax Comm. of Washington*, 320 U.S. 186 (1937); *Alabama -vs- King & Boozer*, 314 U.S. 1 (1941); *U.S. -vs- Detroit*, 355 U.S. 466 (1958).

not the United States Supreme Court clearly define the scope of the requirement (*James -vs- Dravo*, Question 2, supra) that the state tax be "non-discriminatory"? Is the test for possible discrimination made under the Supremacy Clause (*Phillips Chemical* rule) or under the Equal Protection Clause of the Fourteenth Amendment (*Allied Stores -vs- Bowers*, 358 U.S. 522 (1959) *or both?* (See question as posed in *Homestake-Sapin Partners -vs- U.S.*, 375 F.2d 507, 512 (1967))

7. After electing the risks as specified in *England -vs- Louisiana Medical Examiners*, 375 U.S. 411, of participating in and controlling state litigation which was conducted during stipulated abstention of federal litigation, can the Federal Government, when defeated at all state levels, return to the federal forum and relitigate the issues decided in the state court?

8. Are not the real parties in interest barred by the doctrines of *res judicata* and collateral estoppel from relitigating in the Federal Court issues resolved in state court litigation conducted during Federal Court abstention?

STATEMENT OF THE CASE

a) *Kiewit Decisions*

During the period of the Federal abstention, the Montana Supreme Court handed down opinions in both *Kiewit* #1 and #2 and decided:

a) There was a valid distinction for tax purposes between public contractors and private contractors, and the Act was not unconstitutionally discriminatory when gauged by Four-

teenth Amendment, Equal Protection standards.

b) The Act did not unconstitutionally discriminate against the Federal Government under the Supremacy Clause (Art. VI, clause 2, U.S. Constitution) because those contractors who dealt with the State were treated no better than contractors dealing with the Federal Government as required by the *Phillips Chemical* rule.

c) The economic impact of the tax on the Government was not direct nor substantial and since it also was not discriminatory under either Equal Protection rules or Supremacy rules, it met all requirements of *James -vs- Dravo*, 302 U.S. 134.

Kiewit #2 added the ruling that the Act was a valid revenue producing measure.

In November, 1974, after both *Kiewit* decisions the Federal Court denied Montana's motions for Summary Judgment, (J.S. App. 65). Thereafter the case was delayed getting on to trial because the Government desired to conduct an elaborate survey of the impact on in-state contractors -vs- out-of-state contractors of the Act's personal property and income tax credits. The Government hoped to show some discrimination against out-of-state contractors as suggested by the lower court in denying the State's motion for Summary Judgment (J.S. App. 73) and thereby broaden its challenges to the Act beyond what the State courts had decided and so avoid the impact of the *England* and collateral estoppel rules. However, the survey showed that in-state contractors pay an effective tax after credits

and refunds of .44% and out-of-state contractors working in the state pay .46%. In its final judgment the lower Court found the difference "de minimis" and the Government's contention of discrimination against out-of-state contractors to be without merit. (J.S. App. 17).

Immediately prior to trial in the federal court the Government agreed, after some four years of litigation, that the case of *Miller v. Arkansas*, 352 U.S. 187 was applicable and the regulatory provisions of the Act *do not apply* to the United States. (J.S. App. 78). A pre-trial order was prepared by the parties and approved by the trial judge. (J.S. App. 80-104).

b) *Federal Trial*

The case went to trial commencing March 30, 1976 before one of the three-judge panel — Hon. Russell E. Smith. The Government's contentions were: (J.S. App. 92)

1. That the Act discriminates against the United States in violation of the Supremacy Clause in that:
   a) The Federal Government bears the entire burden of the tax.
   b) The Act forces the U.S. to pay more for its construction than does the State of Montana.
   c) The Act forces the Federal Government to pay more for its construction than does a private party.
2. The "legal incidence" of the tax falls on the United States. (rejected below)

3. The Act discriminates against out-of-state contractors. (rejected below)

The State's contentions were: (App. 94)

1. The Act treats federal contractors exactly the same as it treats state contractors and thereby complies with the *Phillips Chemical* rule (361 U.S. 376); does not violate the Supremacy Clause, and is non-discriminatory.

2. There is a valid distinction for tax purposes between public contractors as a class and the class of contractors who perform work for private individuals; and hence, there is no discrimination under the Equal Protection Clause of the 14th Amendment.

3. No tax is laid directly on the U.S.; and the economic impact of the one half of one percent tax on the Government is neither direct nor substantial and therefore complies with the rule of *James -vs- Dravo.* (302 U.S. 134)

4. As the real party in interest in control of the state court litigation, the Federal Government is barred by the doctrines of *England -vs- Medical Examiners,* 375 U.S. 411 and *Drummond -vs- U.S.,* 324 U.S. 316 from returning to the Federal forum and relitigating the case.

5. The Government's contentions that the Act discriminates against the U.S. by violating the Supremacy Clause and/or the Equal Protection Clause were each specifically passed upon by the Montana Supreme Court thereby barring re-litigation of such issues under the doctrine of collateral estoppel.

c) *Lower Court's Majority Decision*
(J.S. App. 5-19)

The majority of the lower court held:

1. There was Supremacy Clause discrimination against the Government because the revenues generated from the Act must be subtracted from the cost of otherwise matching, hypothetical State and Federal projects. Since the revenues of the State Act went to the State and not to the Federal Government, the State is treating itself better than the Government, thereby violating the Supremacy Clause. (J.S. App. 11-13) (The lower court recognized J.S. App. 12 para. 5) but held insignificant the fact that even under its foregoing comparison of costs at the sovereign level (rather than comparison of taxes at the contractor's level), all State subdivisions (cities, counties etc.) were treated exactly the same as the Federal Government since the tax went to the State and not to municipalities, school districts, SID's etc.)

2. While saying that it need not reach the question of discrimination under the Equal Protection Clause, between the classes of contractors taxed and not taxed, the majority nevertheless found under unspecified standards that there was no distinction between public and private contractors and hence there was unlawful discrimination against Government contractors because of the tax on them. (J.S. App. 15-17)

3. Neither the *England* nor collateral estoppel doctrines were applicable. (J.S. App. 12-13)

4. In-state and out-of-state contractors are treated substantially identically and hence no constitutional violation at that level. (J.S. App. 17-18)

d) *Dissent Of Chief Circuit Judge Kilkenny*
(J.S. App. 20-35)

Judge Kilkenny vigorously dissented and noted:

1. Because of the Government's control of the state court litigation, it was bound by the state court results and could not return to the Federal forum and re-litigate. (*England rule*) (J.S. App. 25-26)
2. Collateral estoppel applies and forecloses reconsideration of the key supremacy and equal protection issues. (J.S. App. 23-27)
3. If the majority's Supremacy Clause requirement to deduct the tax from the cost of State construction were valid it would outlaw or "overrule", sub-silentio, the line of cases represented by *Dravo.* (J.S. App. 28) The proper test for Supremacy discrimination is at the level of the contractors who work either for the U.S. or for a division of State Government; and since the Act "treats those who deal with the (federal) Government as well as it treats those with whom it deals", there is no Supremacy Clause violation. (J.S. App. 30-31)
4. The Act doesn't violate Equal Protection standards. The classification between public and private contractors is valid. (J.S. App. 31-33)
5. The legal incidence of the tax is not on the Federal Government. (J.S. App. 34)

SUMMARY OF ARGUMENT

SECTION I

The lower court obliquely found that the Act was unconstitutional under Equal Protection standards of the Fourteenth Amendment as being discriminatory against those who deal with the Government. But in coming to that conclusion, the lower court majority cited *U.S. -vs- County of Fresno,* 429 U.S. 452 (1977), which turns not on equal protection "discrimination" but rather Supremacy Clause "discrimination"; and further, in finding such equal protection discrimination, the lower court failed to cite or apply any of the well-established standards set forth in *Madden -vs- Kentucky,* 309 U.S. 83 (1939) and *Allied Stores -vs- Bowers,* 358 U.S. 522 (1959). Quite apparently the lower court was confused as to the full scope of the "discrimination" question and erred in the application or exclusion of the leading authorities in the field. Consequently, the Argument commences (Sec. I, page 18) with an analysis of "discrimination" under Fourteenth Amendment concepts and notes that such discrimination is separate and apart from the basic rule of *M'Culloch -vs- Maryland,* 17 U.S. (4 Wheat.) 316 (1819).

In the four subdivisions of Section I of the Argument the equal protection tax classification rules as set forth in *Madden -vs- Kentucky,* 309 U.S. 83 are reviewed. From such a study it is apparent that the legislative powers of tax classification are very broad; are presumed to be correct; that a taxpayer (here the Government) seeking to upset such classification on constitutional grounds have a very heavy burden and must rule out every conceivable justification for the classification made by the Legislature.

In Section Ic (p. 21) it is established that the lower court neither cited *Madden* nor applied equal protection rules pertinent to classification. Much later in the brief (Sec. II-g, page 36) after an analysis of the Supremacy Clause discrimination rule as specified in *U.S. -vs- County of Fresno,* 429 U.S. 452 (1977) has been made, the error the lower court in citing *Fresno* as justification for its conclusion that the Act violates equal protection rules is made.

In Section I-d (page 22) the Appellant argues that the lower court was wholly failed to properly analyze the Act as to the tax classification between public and private contractors under established (*Madden* and *Allied Stores*) rules and has erred to the prejudice of Montana and the confusion of the States.

SECTION II

In Section II of the brief the history of the *M'Culloch -vs- Maryland* rule is traced from its inception in 1819 up through *James -vs- Dravo,* 320 U.S. 134 (1937) and *Alabama -vs- King & Boozer,* 314 U.S. 1 (1941).

For the first century *M'Culloch* was given a strict construction such that a state tax with only indirect economic impact on the Federal Government was unconstitutional. (*Weston -vs- Charleston,* 27 U.S. (2 Pet.) 449 (1829) but with the burgeoning of federal and state functions the impracticality of such an application of *M'Culloch* was apparent. Thus, in *Gillespie -vs- Oklahoma,* 257 U.S. 501 (1922) a state income tax on oil and gas recovered by a private lessee of Indian lands was held unconstitutional; and in *Panhandle Oil -vs- Mississippi,* 277 U.S. 218 (1928) a state

sales tax on a distributor of petroleum products selling to the Government was held unconstitutional.

In Section II-b (page 24) of the Argument the new trend of the Court away from *Panhandle et al* is traced and the holding of *James -vs- Dravo,* 320 U.S. 134 (1937) is noted wherein the necessity of a practical application of *M'Culloch* was adopted and a rule announced that a state tax on a private individual which had indirect and inconsequential (2% gross receipts tax) economic impact on the United States was not void under *M'Culloch.* In the same section it is noted that the *King & Boozer* case, supra, overruled *Panhandle Oil.*

Congress, which of course, has the power to legislate in this field, has approved of the Court's swing to a practical application of *M'Culloch* as set forth in *United States -vs- Boyd,* 378 U.S. 39 (1964). This case is cited in Section II-c (page 27) of the Argument.

In Section II-d, (page 29) it is pointed out that under the new trend in *M'Culloch* as represented by *Dravo et al,* the state tax must be "non-discriminatory". Discrimination wasn't a problem under *M'Culloch* prior to *Dravo* because of the total voiding effect of any state tax impact on federal function.

In Section II-d it is pointed out that "discrimination" under the Supremacy Clause is different from "discrimination" under the equal protection clause. The Supreme Court has applied the Supremacy Clause discrimination concept in two cases: *Phillips Chemical Co. -vs- Dumas School District,* 361 U.S. 376 (1960) and *U.S. -vs- County of Fresno,* 429 U.S. 452 (1977).

In Section II-e (page 32) the application of Supremacy Clause discrimination under *Phillips Chemi-*

cal is studied and the rule of the case noted to be that a state must treat those who deal with the Federal Government at least as well as it treats those who deal with the state. The lower court's egregious error in misinterpretation and mis-application of the *Phillips Chemical* rule is then noted. The lower court found discrimination (apparently under *Phillips*) by subtracting the net state tax from the cost of hypothetically-matching state and federal projects. The resulting cost imbalance (since the tax of course went to state and not federal coffers) was cited by the lower court as proof of discrimination against the Government. Such a holding shows a misconception of *Phillips* and also *Dravo* since *Dravo* recognizes that a state tax can have economic impact on the Government. If such a test for Supremacy Clause discrimination were allowed to stand, a host of Supreme Court decisions (*Dravo, King & Boozer* etc.) would be clouded. It is this portion of the lower court judgment which has brought the host of Amici Curiae into this litigation.

In Section II-g (page 36) appellants analyze the court's holding in *Fresno* and note the requirement that the state tax must affect others similarly situated in the same manner as it affects those dealing with the Federal Government. Under the California tax the "others similarly situated" are renters of homes in the private sector, and the Supreme Court found sufficient like treatment under California law in that while no tax was directly laid on such private renter, the tax on his landlord was presumably passed down to him in the form of augmented rent. Under the Montana Act the parallel treatment of the federal contractor and "others similarly situated" is precisely met in that the same identical tax and rate

is levied both on contractors doing business with the Federal Government and those doing business with the state *and with every non-state public entity in Montana* such as school districts, cities, special improvement districts, irrigation and flood districts etc.; and further, that as to watchdog duties of such similarly situated taxpayers in guarding against legislative abuse of tax rates to the embarassment of the Federal Government, the Montana entities could reasonably be relied upon to be at least as alert as their California counterparts since the tax is identified (not included in rent) and private citizen members of school boards etc. are the most cost and tax conscious and civically vocal of any groups in our society.

In Section II-h, (page 38) of the Argument it is pointed out that the lower court majority cited *Fresno* as authority that the Montana Act was "discriminatory" under equal protection concepts. Such a holding is erroneous and greatly muddies the water for the states as to the scope of "discrimination" in this area of intersovereign taxation.

In Section III of the Argument the appellants analyze the lower court majority's error in not sustaining the state's motion for Summary Judgment under *England* after the Government had taken all of the constitutional issues to the Montana state courts in *Kiewit #1 and #2* and, after adverse determinations there, had sought to return and relitigate them in the Federal Court. In Section III (page 42) the lower court's error is not recognizing the applicability of collateral estoppel rules as to litigated issues in the state courts is related.

The Conclusion of the Appellants is set forth commencing at page 49.

ARGUMENT

I.

THE ACT IS NOT DISCRIMINATORY UNDER EQUAL PROTECTION STANDARDS

The lower court obliquely found that the Act was discriminatory under the Equal Protection Clause of the Fourteenth Amendment and specifically found that it violated the Supremacy Clause. In each such finding the court erred.

a) *Brief Consideration of Equal Protection Rules is Necessary*

Since the lower court only left-handedly condemned the Act as violating the Equal Protection Clause of the Fourteenth Amendment, the discussion of alleged discrimination under that clause will be kept brief; however, the subject matter must be treated, for the Government in its attack on the Act has played the "discrimination" field to its fullest. (J.S. App. 93) Also in the Montana Supreme Court in *Kiewit #1*, equal protection "discrimination" was the Government's principal argument (161 Mont. 140, 146; 505 P.2d 102, 106; J.S. App. 114), even though now it appears that only Supremacy Clause "discrimination" is relied upon. (Main Appendix 5 hereinafter "M.A.")

Just what "discrimination" means and how it is gauged in this category of litigation isn't at present entirely clear to bench and bar. *Homestake-Sapin Partners -vs- United States*, 375 F.2d 507, 512 (1967). Whenever there is a state tax which has potential economic impact on the Government, a supremacy issue is raised and *M'Culloch -vs- Maryland*, 17 U.S. (4 Wheat.) 316 (1819) becomes relevant.

But *M'Culloch* did not involve, as here, the basic question of a tax directly on private citizens and with only indirect and insubstantial economic impact on the United States (as in *Dravo*). *M'Culloch* involved an attempt by Maryland to directly tax the Maryland branch of the Bank of the United States recently created and incorporated by Act of Congress. There was no discussion in the decision of "discrimination." There could be none because the holding of the case was that Maryland was absolutely powerless to directly tax the United States Bank. There could be no question of mechanics of the tax; it was totally and fundamentally void. Subsequently herein, the application over the intervening century of *M'Culloch* principles to taxing situations directly involving private taxpayers and only indirectly involving the Government by remote economic impact (*Dravo*) will be discussed, and it will be seen that, then, for the first time, the requirement of "non-discrimination" comes into the decisions. But historically, in tax parlance, "discrimination" pertains to tax classification and Fourteenth Amendment equal protection rights and not to the Supremacy Clause enunciated in *M'Culloch*. *Madden -vs- Kentucky*, 309 U.S. 83 (1939); *Charleston Fed. Sav. & L. Assn. -vs- Alderson*, 324 U.S. 182 (1944); 71 Am.Jur.(2d) 491, 495, Sections 172, 173, *et seq.*

b) *Legislative Powers of Tax Classification are Broad*

In the *Madden* case, supra, the following rules applicable to tax classification were enunciated:

1. State legislatures have broad discretion as to classification for tax purposes.

2. The Fourteenth Amendment was not intended to compel a state to adopt an iron rule of equal taxation.
3. In taxation, more than in other fields, legislatures possess the greatest freedom in classification.
4. Classification by a legislature is presumed to be constitutional.
5. A court will not declare a classification void under the equal protection clause except upon the most explicit demonstration that the classification is a hostile and oppressive discrimination against particular persons and classes.
6. The burden is on the one attacking classification to negative every conceivable basis which might support it.

The Montana Supreme Court reviewed the evidence adduced in the state court trial of *Kiewit #1* and found that the classification between public contractors who paid the tax and private contractors who paid no tax was valid.

> "We believe that a distinction between public and private contractors is not arbitrary or capricious and following the reasoning of the United States Supreme Court — the State of Montana has the power to make such a distinction and the statute in question is not unconstitutional."
>
> *Kiewit -vs- State Board*, 161 Mont. 140, 151, 505 P.2d 102, 109, J.S. App. 119

See also *Brown-Forman Co. -vs- Kentucky*, 217 U.S. 563 (1910), relied upon by the Montana Court;

Allied Stores of Ohio -vs- Bowers, 358 U.S. 522 (1959).

At the trial in the federal court, testimony was also adduced showing real and substantial differences between public contracts and private contracts. (M.A. 177, *et seq.*)

c) *Lower Court Finds Equal Protection Violation Without Applying Madden-type Standards*

Discrimination under equal protection standards must be tested at the true taxpayer level. The Government in its contentions at the trial below claimed that the tax "discriminated against those with whom the Government does business" (J.S. App. 8) — i.e., public contractors. The lower court obliquely agreed without citing any authorities, without reviewing *Madden* rules and without in any wise requiring or making "the most explicit demonstration" of oppressive and hostile discrimination as demanded by *Madden*.

> "It is manifest to us that as between Contractors and large structure private contractors, there is no reasonable or rational factual basis for the demonstrated unequal treatment under the Act."
>
> J.S. App. 16

If the Lower Court was determined to make an evaluation of the tax classification under the Equal Protection Clause or at least be inferentially critical of the constitutionality of the Act as it so expressed itself, then the evidence and the law should have been properly reviewed. Had this been done, it is respectfully submitted that the classification would have been upheld! The dissent of Judge Kilkenny (J.S. App. 33) was explicit in noting the Govern-

ment's burden of proof and the Court's required standard of review, Judge Kilkenny would have upheld the classification:

> "*Kiewit #1* held that a valid tax classification lay between public and private contractors and I do not think that the federal government has shown otherwise. I find no evidence in the record to show that the government met its burden of proof. Testimony offered by the State of Montana, on the other hand, attests to the real and substantial differences between the two classes of contractors. For equal protection purposes, there is a very liberal standard of review and cases will be upheld if there is any conceivable basis which will support the classification. (citations) . . . In short, I think that the federal government has failed in its burden of showing the classification improper. In view of the standard of review, I would uphold the classification."
>
> Kilkenny Dissent (J.S. App. 33)

d) *Conclusion: The Court Erred In Finding Equal Protection Violation*

It was proved at trial that there is a real and substantial difference between public and private contractors. Such classification as made by the Legislature and ratified by the Montana Supreme Court is presumed sound. By no means did the Government prove that there is no conceivable basis for such classification. Since the classification is valid, the public contractor doing business with the Federal Government is not discriminated against and the Lower Court erred in so finding.

II.

THE LOWER COURT ERRED IN FINDING SUPREMACY CLAUSE DISCRIMINATION

a) *Period of Strict Construction of M'Culloch*

From the period of the *M'Culloch* decision in 1819 into the 1930's, the court strictly construed *M'Culloch*, and the rule was that any state tax which directly or indirectly could "retard, impede, burden, or in any manner control the operation of the constitutional laws enacted by Congress to carry into execution the powers vested in the General government" was void.

Weston -vs- Charleston, 27 U.S. (2 Pet.) 449 (1829)

With the increasing activities of both federal and state governments, the states found themselves more and more in potential conflict with such a rule. In *Gillespie -vs- Oklahoma*, 257 U.S. 501 (1922), Oklahoma was forbidden under *M'Culloch* from levying a state income tax on the oil and gas income of a private individual in Oklahoma who had leased Indian lands and produced and sold oil and gas therefrom. Since the lands belonged to the Indians as wards of the Government, the tax was held to be an impediment to the Government's obtaining the best possible terms for the Indians from private lessees of such lands and thereby frustrated its federal function.

And in *Panhandle Oil Co. -vs- State of Mississippi*, 277 U.S. 218 (1928), a state sales tax on private gasoline distributors of three to four cents per gallon was held void as to gasoline sold by a private distrib-

utor to the United States for use in Coast Guard vessels and a federal veterans hospital.

> "The United States is empowered by the Constitution to maintain and operate the fleet and hospital. (Art. 1, Sec. 8.) That authorization and laws enacted pursuant thereto are supreme (Article 6); and in case of conflict, they control state enactments."

See also *Graves -vs- Texas Co.,* 298 U.S. 393 (1936).

This period of the 1930's and early 1940's witnessed burgeoning federal projects and heavy construction works of the nature of federal dams and war-related federal projects in the United States. On the one hand, such huge projects (e.g., Grand Coulee dam) brought potentially great fees and sales income to local contractors and suppliers. On the other hand, the pressure on the states for vastly augmented housing, schooling, police protection, fire protection, etc., for construction crews and their families was enormous. How could the states perform their functions if the income of the private contractors was exempt under *Gillespie* and the sales of materials for use in government projects was tax exempt under *Panhandle?* In a comparison of impacts on the dual system of state and federal governments, how could the slight impediment to federal function by indirect economic impact of state taxes on federal construction fairly be said to outweigh the badly needed revenues precluded to the states?

b) *Court Adopts Practical Application of M'Culloch Recognizing Need for States' Co-Existence*

The rules of cases such as *Gillespie* and *Panhandle Oil* were not required by the *M'Culloch* holding.

> "That the power of taxation is one of vital importance; that it is retained by the states; that it is not abridged by the grant of similar power to the government of the Union; that it is to be *concurrently exercised by the two governments* are truths which have never been denied." (Emphasis supplied).
>
> *M'Culloch -vs- Maryland,*
> 17 U.S. (4 Wheat.) 316, 425

> "It cannot be that a state tax which remotely affects the efficient exercise of a federal power is for that reason alone inhibited by the Constitution. To hold that would be to deny to the States all power to tax persons or property. Every tax levied by a State withdraws from the reach of federal taxation a portion of the property from which it is taken, and to that extent diminishes the subject upon which federal taxes may be paid. The States are, and they must ever be, coexistent with the national government. Neither may destroy the other. Hence, the federal Constitution must receive a practical construction. Its limitations and its implied prohibitions must not be extended so far as to destroy the necessary powers of the States or prevent their efficient exercise."
>
> McReynolds dissent in *Panhandle,* 277 U.S. 218, 225, 226

In 1937, the Court decided *James -vs- Dravo Contracting Co.,* 302 U.S. 134 and its companion case of *Silas Mason -vs- Tax Comm. of Washington,* 302 U.S. 186. In 1941, in *Alabama -vs- King & Boozer,* 314 U.S. 1, the Court specifically overruled *Panhandle.*

Dravo involved a West Virginia contractors' gross receipts tax of 2%, which was challenged by a contractor performing construction work for the Government as impeding performance of a federal function. The Court held that since the tax was on the contractor with only indirect and inconsequential economic impact on the Government, the tax was not outlawed by *M'Culloch.*

King & Boozer involved a 2% sales tax imposed by Alabama on materials furnished by King and Boozer as materialmen to the cost-plus contractors doing work for the Federal Government. Under *Panhandle,* supra, the tax would have been void; however, the Court specifically overruled it and upheld the tax.

In 1942 in *Penn Dairies -vs- Milk Control Comm.,* 318 U.S. 261, 270, the Court noted as to its recent decisions:

> "The trend of our decisions is not to extend governmental immunity from state taxation and regulation beyond the national government itself and governmental function performed by its officers and agents. We have recognized that the Constitution presupposes the continued existence of states functioning in coordination with the national government, with authority in the states to lay taxes and to regulate their internal affairs and policy, and that state regulation like state taxation inevitably imposes some burdens on the national government of the same kind as those imposed on citizens of the United States within the state's borders. (citations) And we have held that those burdens, save as Congress may act to remove them, are to be regarded as the normal incidents of the operation within the same territory of a dual system of government, and that no immunity of the national government from such burdens is to be implied from the Constitution which established the system. (citation)

See also *Oklahoma Tax Commission -vs- Texas Co.,* 336 U.S. 342, 352 (1949).

c) *Congress Approves Court Shift*

The Court has always recognized that Congress could specifically legislate in the field being discussed.

> "Congress has declined to pass legislation immunizing from state taxation contractors under 'cost-plus' contracts for the construction of governmental projects. Consequently the participants in the present transaction enjoy only such tax immunity as is afforded by the Constitution itself, and we are not now concerned with the extent and appropriate exercise of the power of Congress to free such transactions from state taxation of individuals in such circumstances that the economic burden of the tax is passed on to the national government."
>
> *Alabama -vs- King & Boozer,* 314 U.S. 1, 8 (1941)

Since *King & Boozer,* the Congress has specifically acted to indicate its approval of state taxation in this field. In *United States -vs- Boyd,* 378 U.S. 39 (1964), Tennessee levied and collected a tax on a contractor's right to use tangible personal property owned by the United States (Atomic Energy Commission) and situated at Oak Ridge, Tennessee. The tax was enacted by Tennessee after Congress in 1953 repealed the statutory immunity from taxation of contractors performing work for the AEC. The

Court noted the knowledge of Congress in the field and its desire to permit the states to tax private individuals performing even cost-plus contracts for the Federal Government:

> "It is undoubtedly true, as the Government points out, that subjection of government property used by AEC contractors to state use taxes will result in a substantial future tax liability. But this result was brought to the attention of Congress in the debates on the repeal of Section 9(b), which exempted the activities of AEC contractors from state taxation; indeed the AEC argued that the repeal would substantially increase the cost of the atomic energy program by subjecting AEC contractors to state 'sales and use taxes' and 'business and occupation' taxes. Nonetheless, Congress, well aware of the principle that 'constitutional immunity does not extend to cost-plus-fixed-fee contractors of the Federal Government, but is limited to taxes imposed directly on the United States,' S.Rep. No. 694, 83d. Cong., 1st Sess., 2, repealed the statutory exemption for the declared purpose of placing AEC contractors in the same position as all other government contractors. Act of August 13, 1953, c. 432, 67 Stat. 575. The principles laid down in King & Boozer, Curry, Esso, and Muskegon, we think, strike a proper judicial accommodation between the interests of the states' power to tax and the concerns of the Nation, they are workable, and we adhere to them. If they unduly intrude upon the business of the Nation, it is for Congress, in the valid exercise of its proper powers, not this Court, to make the desirable adjustment.
>
> *United States -vs- Boyd*, 49, 50, 51

See also *United States -vs- Detroit*, 355 U.S. 466, 474 (1958).

d) *Requirement That the State Tax Be "Non-Discriminatory"*

From the inception of the modern rule under *Dravo* and *King & Boozer*, the Court has always specified that although a tax does not violate the *M'Culloch* sovereignty rule if it imposes some indirect, insubstantial economic impact on the Government, such tax must be "non-discriminatory."

> "It still remains true, as it has from the beginning, that a tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the government or those with whom it deals."
>
> *United States -vs- Detroit*, 355 U.S. 466, 473 (1958)

See also: *James -vs- Dravo Contracting Co.*, 302 U.S. 134, 149 (1937); *Detroit -vs- Murray Corp.*, 355 U.S. 489 (1958); *United States -vs- County of Fresno*, 429 U.S. 452, 460 (1977).

d-i) *Meaning of "Discrimination" Under the Supremacy Clause*

Under Section I of this brief, page 18, *et seq.*, the law pertinent to "discrimination" in the Equal Protection field was discussed and the error of the lower court majority in not sustaining the tax as non-discriminatory was noted.

In this Section II of the brief, the validity of the Act under a Supremacy Clause challenge is being studied. Since the law pertinent to Supremacy cases also requires "non-discrimination" as a condition of

constitutionality, the natural inquiry of bench and bar is whether "discrimination" for Supremacy purposes is the same as "discrimination" for Equal Protection purposes.

> "Whether a tax discriminatory against the United States is unconstitutional under the Fourteenth Amendment, the supremacy clause, or both, is a question the Supreme Court has not had an occasion to answer."
>
> *Homestake-Sapin Partners -vs- United States,* (CA 10, 1967), 375 F.2d 507, 512

Appellant, State of Montana, respectfully submits that there are two constitutional requirements for the validity of a state tax of the nature here involved: valid classification (non-discrimination) under equal protection standards as measured by *Madden* rules; and that the tax be "non-discriminatory" under Supremacy Clause rules as enunciated in *Phillips Chemical Co. -vs- Dumas School District,* 361 U.S. 376 (1960) and *United States -vs- County of Fresno,* 429 U.S. 452 (1977). So Montana's proposed response to the *Homestake* inquiry is "both."

d-ii) *The Phillips Chemical Discrimination Rule*

Neither *Dravo* nor any of the subsequent cases in the field up to *Phillips Chemical Co. -vs- Dumas School District,* 361 U.S. 376, defines supremacy clause "discrimination." When the Montana Supreme Court decided *Kiewit #1* in 1973, the *Fresno County* case had not been decided.

The non-discrimination rule of *Phillips* is that a state must treat those who deal with the Federal

Government at least as well as it treats those who deal with the state.

> "Accordingly, it does not seem too much to require that the State treat those who deal with the (federal) government as well as it treats those with whom it deals itself."
>
> 361 U.S. 385

In *Phillips Chemical,* Texas imposed a tax on lessees of federal real property but not on lessees of state real property, and so the tax discriminated against the United States and was void under the Supremacy Clause.

The Montana Supreme Court in *Kiewit #1* adopted the *Phillips*[2] definition of discrimination and found that the Act in question treats those who deal with the Federal Government precisely as it treats those contractors who do work for the state:

> "(9) Here, we do not believe that the state of Montana has discriminated against the federal government. The federal government is being treated in the same manner as the state of Montana treats itself and its subdivisions or municipalities. The only discrimination the federal government can claim is that private contractors are not paying the same tax as public contractors. However, according to case law, all the United States Supreme Court has required is that the state does not give itself special treatment over that received by the federal government. The Act involved here treats the federal government in the same manner as it treats those who deal with any

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[2]And *Moses Lake -vs- Grant County,* 365 U.S. 744 (1961).

part of the state government. The second half of the discrimination question is denied."

J.S. App. 121

Since the Act levies an identical gross receipts tax on those contractors who perform work for the state or for the Federal Government or for any of the myriad school district, counties and all other public bodies in Montana, the conclusion of the Montana Supreme Court appears fully justified; however, the federal court below erroneously found otherwise.

e) *Lower Federal Court Misconstrues and Misapplies Phillips Discrimination Rule*

The lower court majority in this case misread and misapplied the *Phillips Chemical* holding. For a test of Supremacy Clause discrimination, the lower court assumed hypothetically-matching state and federal projects. As to the state project, it then deducted the net state tax; and since the tax produced revenue for the state and not for the Government, there was no comparable deduction available to the hypothetical government project; so there was "discrimination" against the government.

> "It is manifest from the above findings of fact that as between the State and the Government, the imposition of the G. R. Tax upon Contractors discriminates against the Government and in favor of the State. Although a public contractor for the State might add the G. R. Tax as a line item in his bid and thus increase the cost of construction, the State would receive as general revenue that portion of the G. R. Tax remaining after allowing credits and refunds. As indicated, that averages slightly less than 50 percent of the G. R. Tax. Contra, the Government is required to pay through increased bids by the imposition of the G. R. Tax and gets no return of the overplus of approximately 50 percent."
>
> (J.S. App. 13)

But, as the dissent indicates, the affirmance of such a holding would overrule a long line of cases represented by *Dravo, King & Boozer* (and others cited below):

> "The reasoning of the majority *sub silentio* overrules this and other authority. In each of the above cases, the tax would apply equally to those doing work for the state government. Applying the reasoning of the majority, there is discrimination against the federal government because the otherwise legitimately-collected tax (general state revenue) reduces the state's net cost, thereby allowing it to spend less than the federal government. Thus, under the guise of discrimination against the federal government, any state tax could be traced backwards to defeat its own existence."
>
> (J.S. App. 28-29)

In each of the following intergovernmental tax cases revenues from a state tax went to the state and not the federal government thereby "discriminating" against the Government if it is proper in testing for Supremacy Clause discrimination to compare hypothetical state and federal projects and deduct the tax from the cost of the former.

> *James -vs- Dravo Contracting Co.*, 302 U.S. 134 (1937)
>
> (2% gross tax on construction contractors — including those working for federal government.)

Alabama -vs- King & Boozer, 314 U.S. 1 (1941)
(2% sales tax on private gas distributor to either federal or state facilities with a cost-plus contract for federal government.)

Silas Mason Co. -vs- Tax Comm. of Washington, 302 U.S. 186 (1937)
(2% tax on gross income of construction contractors — state or federal.)

United States -vs- Boyd, 378 U.S. 39 (1964)
(State use tax on property owned by state or federal governments but used by independent contractors in their performance of state or federal contracts.)

Phillips Chemical did not require any such cost comparison test for Supremacy Clause discrimination as made here by the Lower Court, nor does the lower majority cite any case that does.

Furthermore, in arriving at its "rule," the lower court wholly ignores all of the non-federal, non-state, public construction entities in Montana. As to all such construction, there is no way, hypothetically or otherwise, that the net revenue from the state tax can be set off against construction costs so as to create an imbalance vis a-vis the Federal Government. Every city, school district, etc., project costs EXACTLY the same as a matching hypothetical federal project!

Next, the lower court holding ignores the uncontested facts that departments of the state itself which embark on construction projects have to budget for allotted construction money; they must construct within the budget, they must depreciate and insure the property for what it truly cost the particular department and have no possible way of allocating general tax funds derived from the tax back to

the cost of a project to factually or hypothetically change any of the foregoing. (M.A. 185). There is no amorphous pot of state funds into which departments of the state can dip to reduce costs.

And finally, the Lower Court's use of hypothetically-matching state and federal projects and a comparison of "costs" pertinent thereto is no more affected by a hypothetical reduction of state construction costs by "feedback" of the tax revenues of the Act itself than the cost of the federal construction would be reduced by tracing a feedback against federal construction costs from federal income tax revenues levied by the Government against the profits of the contractors and the wages of the construction crews. Federal funds are no more or less amorphous than state funds. A federal project in Montana doesn't cost less because the contractor is a private individual in a high personal income tax bracket generating substantial revenues for the Federal Government as he labors to construct the project. There is no authority in fact, case law or logic for the Court's accounting method in finding "discrimination."

f) *Conclusion on Lower Court's Mis-application of Phillips Definition of Discrimination*

If the lower court's interpretation of the *Phillips Chemical* test for Supremacy Clause discrimination is allowed to stand, the relationship of the states to the Federal Government in this field of state taxation would be back at the pre-*Dravo* days. The "workable" judicial accommodation between the interests of the states' power to tax and the concerns of the "Nation" referred to in *United States -vs- Boyd* (378 U.S. 39, 51) will have been lost. It is respectfully submitted that this Court should not allow the lower court holding to stand.

g) *Application of "Discrimination" Under United States -vs- County of Fresno*

The Supreme Court handed down its decision in *United States -vs- County of Fresno* on January 25, 1977, which was after both *Kiewit* cases had been decided by the Montana Supreme Court, after the statement of contentions of the parties and trial of the case below, but prior to the lower federal court's decision here.

California tax laws impose a tax on the possessory interest which private citizens hold in non-taxable, publicly-owned real property. Thus, private renters of federal properties have to pay a tax on the fair rental value of the property leased by them. (Title 18, Cal. Adm. Code, Section 21(b) (1971))

In *Fresno,* Forest Service employees occupying residences rented from the federal government challenged the tax as being discriminatory against them (and the federal government) because no like tax is imposed on renters of privately-owned property. However, under the authority of *United States -vs- Detroit,* 355 U.S. 466 (1958), the Court held that the property tax on owners (lessors) or private rental-housing can be presumed to be passed down to the renter-lessee:

> "Similarly, here the State of California imposes a property tax on owners of nonexempt property which is passed on by them to their — lessees. Consequently, the appellants who rent from the Forest Service are no worse off under California tax laws than those who work for private employers and rent houses in the private sector."
>
> *United States -vs- County of Fresno,* 429 U.S. 452, 465

The spirit of the *Fresno* rule is met under the California tax statutes by the inference or conclusion that the rent paid by an individual renting residential property in the private sector includes "passed-down" taxes matching the California tax on Forest Service renters. No proof of an exact match of tax impact on federal and private renters nor proof of actual pass-down in every instance ever was required. The Montana Act is much more explicit. The members of the class in Montana similarly situated to the Federal Contractor — e.g., the public contractor performing a contract for a Montana city, incorporated town, school board, etc., is a *taxpayer* who pays identical taxes under the same Act as a federal contractor performing a job for the Federal Government. And such tax impact as the Federal Government experiences under the Act is experienced dollar for dollar and penny for penny by public owners of school or municipal construction projects such as sewage lagoons or irrigation districts, etc!

Under the *Fresno* rule, the California renters in the private sector (and their tax-impacted lessors) are relied upon under *M'Culloch* concepts to play watchdog roles on behalf of themselves and their fellow class members (including renters from the Government and the Government itself) in opposing oppressive taxation by some future California Legislature. Appellants respectfully submit that a comparable role can and will be played as to the Montana Act by the contractors working for cities and school districts, etc., and by their contractees — the tax- and cost-conscious school board members and ranchers on irrigation district boards. They well might be expected to outperform their California counterparts in that as to the Montana tax, the

economic impact is not guised in passed-down rent but is a line item paid by the contractor and precisely tied (1%) to the construction contract awarded by the particular Board. Furthermore, such boards epitomize the diligent tax- and cost-conscious citizen watching expenses for his constituents.

The rule of *M'Culloch* as brought up to date through *Dravo, Phillips Chemical* and *Fresno County,* therefore, simply is:

> "The rule to be derived from the Court's more recent decisions (*Dravo,* et al.) then, is that the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on other similarly situated constituents of the State."
>
> *United States -vs- County of Fresno,* 429 U.S. 452, 462

And such current rule also accords with *M'Culloch,* since the Court there limited its holding so as not to:

> "extend to a tax — imposed on the interest which the citizens of Maryland may hold in this institution (the bank) *in common with other property of the same description throughout the State."* (Emphasis by Fresno Court)
>
> *United States -vs- County of Fresno,* 429 U.S. 452, 459

h) *Lower Court Misconstrues Fresno and Applies It in the Context of Equal Protection Discrimination*

The Lower Court makes no analysis of *Fresno* in the context of discrimination under the Supremacy Clause. The case is cited only once in the opinion and there in support of the Court's conclusion that the classification for tax purposes between public and private contractors is unjustified and so discriminates against the Government.

> "It is manifest to us that as between (public?) Contractors and large structure private contractors (footnote) there is no reasonable or rational basis for the demonstrated unequal treatment under the Act." (Parenthetical inserts supplied)
>
> J.S. App. 16 citing *Fresno,* 429 U.S. 452, 462
>
> See court footnote expanding on equal protection concepts

And since nothing in *Fresno* deals with equal protection tax classification standards as in *Madden* and *Allied Stores,* supra, page 19, the Lower Court's opinion adds great confusion to the proper standard for making a determination of alleged discrimination in cases of this nature.

i) *Conclusion on Lower Court's Finding of Discrimination Against the Federal Government*

Montana recognizes in cases such as this that the Supremacy Clause must be abided by and the requirement of non-discrimination against the Federal Government and those with whom it deals must be met. And it is clear from the *Phillips Chemical* and *Fresno County* cases that "discrimination" under the Supremacy Clause involves different legal pre-

cepts from "discrimination" under the Equal Protection Clause.

Montana further believes that the Supremacy Clause, non-discrimination rules announced in *Phillips Chemical* and *Fresno County* cases are reasonable, clear and imperative. And, as set forth above in this Argument, Appellants submit that the Montana Act passes muster under such tests AS SET FORTH IN THE OPINION LANGUAGE OF THE SUPREME COURT.

But Appellants respectfully submit that the interpretation of *Phillips Chemical* and *Fresno County* cases made and applied by the Lower Court are disastrous of the new *M'Culloch* rule trend adopted by the Supreme Court in *Dravo* and *King & Boozer* and approved by the Congress in *Boyd.* No state tax case otherwise valid under *Dravo* can pass the Lower Court's discrimination test that the tax itself can be deducted from the cost of state projects to show a "discrimination" cost imbalance between the dual governments violative of Supremacy Clause rules. And the Lower Court's citation of the *Fresno* case rather than *Madden* or *Allied Stores,* etc., in finding equal protection "discrimination" greatly muddies the water for the states.

The Montana Act is no "scheme" (Motion to Affirm 11) to bilk the Government. Under it, the State of Montana in a fair and candid manner can force transient contractors doing business in Montana for state, federal and local public projects to pay property taxes on evanescent construction equipment used and income taxes earned in Montana. (*Kiewit #1,* J.S. App. 112, 113) Additionally, a modest amount of true tax revenue is raised which impacts identically as to cost on the State, the Federal Government and local

public entities. As guardians for themselves and the Federal Government against any oppressive augmentation of tax by the Legislature, there stand the school boards, etc., composed of cost- and tax-conscious voting private citizens.

Ours is a federalist system of government where the dual sovereignties must forever co-exist:

> "The States are, and they must ever be, co-existent with the national government. Neither can destroy the other. Hence, the federal Constitution must receive a practical construction. Its limitations and its implied prohibitions must not be extended so far as to destroy the necessary powers of the States or prevent their efficient exercise."
>
> McReynolds Dissent in *Panhandle Oil Co. -vs- Mississippi,* 227 U.S. 218, 226

While the dollars at risk under the Lower Court's decision are important to Montana, of far more importance to it and to all of the states is the lawful power consistent with the Equal Protection Clause and the modern application of the Supremacy Clause to run its own show and discharge its obligation to its citizens in the manner specified by them. Very possibly there will be more federal funds allocated in Montana under the revenue sharing program than this tax has generated or will foreseeably generate. But the several states must not be tied to the federal apron strings; nor should the Federal Government be encouraged to be unreasonably testy of the efforts of their counterparts in this system of dual governments to separately discharge their obligations to their citizens.

Appellants respectfully submit that the Act is valid under the Equal Protection Clause and under the Supremacy Clause. The Lower Court completely misconstrued and misapplied the Supreme Court authorities in the field to the total confusion and frustration of the states. The judgment should be reversed and the constitutionality of the Act affirmed.

III.

THE GOVERNMENT ELECTED TO LITIGATE ITS CHALLENGE TO THE CONSTITUTIONALITY OF THE ACT IN THE COURTS OF THE STATE OF MONTANA AND IS THEREFORE BARRED FROM RELITIGATING THEM IN THE FEDERAL COURTS.

In the two opinions issued by the three judge federal court in this matter, a full determination of whether or not the Government had freely and without reservation litigated its challenge to the Act in the state court has never been made. In the court's Order of November 18, 1974, (J.S. App. 65) the court in footnote 1, p. 69 did not decide but specifically held open the question of whether or not under the facts and circumstances of the case the Government had submitted its claims to the courts of Montana and was therefore barred from relitigating the question in the Federal Court.

In the final opinion and order of the majority (J.S. App. 5) the court discussed in a very brief fashion the issues relating to collateral estoppel and res judicata (see this brief, post 46 for Montana's contention relative to those issues) but never discussed the question of whether or not the Government was barred from relitigating its entire case.

A review by this court of the record will clearly indicate that the Government did freely and without reservations submit all of its claims in the state court and is now barred from relitigating them at this time.

Appellants cite *England -vs- Louisiana Medical Examiners*, 375 U.S. 411, (1964) which supports this position. The ruling of *England*, supra, requires that if a party freely and without reservation submits his federal claims for decision by the state courts, litigates them there, and has them decided there, he thereby gives up his right to return to the federal courts to renew the litigation. A review of the facts in this case indicates clearly the Government has done exactly that in this situation.

The Government filed its complaint in the federal court in April, 1971 less than a month after a near-identical complaint was filed in the state court (Kiewit #1). Both the complaint in *Peter Kiewit*, and the original complaint in the litigation are attached to the appendix herein, p. 33 and 9 respectively, and a review of them indicates that what the plaintiff Peter Kiewit was requesting was essentially identical to what the Government requested in their own complaint. After the filing of the complaint, the parties entered into a stipulation (J.S. App. 49) which was later amended (J.S. App. 160) but which clearly indicates the intent of the parties to hold the federal action in abeyance while the issues were litigated in the state court.

Whether or not the order affectuating the stipulation of the parties was denominated as one for a continuance or abstention is of little importance when the reasons justifying the continuance are the

same as used for justifying the use of the abstention doctrine. The doctrine evolved out of the equitable powers of the federal court allowing the federal court to stay proceedings on the ground that if the questions of state law were first decided by state courts the settlement of those questions might end the controversy; therefore, the matter would be deferred in the federal court pending a decision by the state court. See *England*, supra, *Harrison -vs- N.A.A.C.P.*, 360 U.S. 167 (1959), *Louisiana Power and Light Co. -vs- Thibodaux*, 360 U.S. 25 (1959).

The stipulations and orders entered in this matter leave no doubt that such was the intention of all the parties. The orders and stipulations provided that this matter would be held without date pending a final resolution on *Kiewit #1* by this very court. Whether or not the order was specifically entitled "abstention" does not change the effect of what happened. The parties hereto wanted the abstention doctrine to apply so that if the Supreme Court of Montana ruled the Act unconstitutional in *Kiewit #1*, this case would be terminated. The parties provided specifically for an appeal to this court, which was filed but ultimately negated by the Solicitor General. Assuming then the doctrine is applicable, it is then necessary to determine whether or not the Government litigated freely and without reservation its claim in the state courts, (*England*, supra).

A review of the record indicates that the Government has so litigated its claims. The Governments Answer to Request for Admission number 69 listed in the appendix page 76, lists the specific aspects of the original *Kiewit* case over which they exercised control. The complaints themselves establish that

the issues were essentially identical. Further, the appeal which was filed with this court from the original *Kiewit #1* decision, was dismissed at Kiewit's request after the then Solicitor General, Erwin N. Griswold, indicated his disapproval of the appeal and withdrew the Government's financial support. The Government has completely failed to show when or how it informed the state court of any intention to return to the federal action. The record establishes that it unreservedly briefed, argued and obtained a decision on all issues in the state courts. After two years of active litigation through the Montana courts and after having come to the door of this very court, the Government after seeking consultation with corps of army engineer attorneys, tax department attorneys and of the Solicitor General himself, endeavored to abandon its earlier election of full scale litigation in the state court and to reenter the federal forum and start over again.

> "We explicitly hold that if a party freely and without reservation submits his federal claims for decision by the state court, litigates them there, or has them decided there, then, whether or not he seeks direct appeal of the state court decision in this court, he has elected to forego his right to return to the district court." *England*, supra, page 47.

It is incumbent on the Government to demonstrate how they reserved any of their claims in the state court. The state respectfully submits that the Government in this instance freely and without reservation submitted its constitutional challenges of this Act to the courts of Montana and under the decision of *England*, supra, is precluded from reinstituting the same issues in this forum.

IV.

THE DOCTRINE OF COLLATERAL ESTOPPEL PRECLUDES THE GOVERNMENT FROM RELITIGATING THOSE SPECIFIC ISSUES DECIDED IN THE ORIGINAL PETER KIEWIT LITIGATION.

Assuming this court were to find that in some way the Government did not freely and without reservation submit its claims to the state court, the doctrine of collateral estoppel precluded the Government from relitigating in this forum those specific issues previously decided by the Montana court.

As has been established, the Government was the real party in interest (M.A. page 78, subsection M) in the *Kiewit #1* litigation, and under the doctrine of collateral estoppel, the same parties are precluded from relitigating the same issues in a different cause of action. See *Drummond -vs- United States,* 324 U.S. 316 (1945), *Southern Pacific Railroad -vs- United States,* 168 U.S. 1 (1897), *Gardner -vs- Public Bank,* 417 F.2d 75 (1969), *Western Montana Production Credit Association -vs- Hydrophonics, Inc.,* 147 Mont. 157, 410 P.2d 937 (1966), 1-B Moore F. P. 621-622 Sec. 0.405.

The issues raised in the previous litigation which have been reinstated in this case are the following:

(a) Discrimination against the United States. The Government in paragraph 24 (a) of its amended complaint (M.A. page 65) and in section 2(a) page 12 of the pre-trial order (J.S. App. 93) contended that the act was illegal because it discriminated against the United States, its agencies, instrumentalities and those with whom it does business. Referring to the decision by the majority herein (J.S. App. 13) it was

held that the act was in fact invalid because the imposition of the tax discriminated against the Government and in favor of the state.

> "We conclude and declare that the imposition of the G. R. tax under the act upon the contractors subjects the government to discrimination in favor of the state, all in violation of the Supremacy Clause. . .
>
> However, nothing in the issues raised presented, nor did the contractor Kiewit have standing to raise on behalf of the Government in *Kiewit,* the Government's current issue of discriminatory effect upon it as an owner-builder by the imposition of the G. R. tax upon its contractors in violation of the Supremacy Clause." J.S. App. p. 14-15.

However, such a decision fails to follow the plain language in *Kiewit #1.* The Supreme Court of Montana indicated the issue raised by *Kiewit* on behalf of the Government as follows:

> "The second half of the discrimination question raised by Appellant is that this tax discriminates against the federal government. It urges that the state of Montana is required to treat the United States and other public bodies as well as it treats private non-governmental parties. Appellant contends granting a preferred tax status to a substantial number of taxpayers, contractors performing work for private owners, and failing to grant a comparable status to construction contractors of the United States, constitutes unconstitutional discrimination against the United States and those with whom it deals." (J.S. App. 119)

Clearly that specific contention of the Government has been again raised in this present case. What the

majority opinion tries to do is to discount the effect of the decision by the Supreme Court of Montana by simply not acknowledging the existence of the language. However, it is present and it cannot now be argued that the issues were not raised in the original Kiewit litigation. The Kiewit litigation could have involved a very simple legal question of whether or not a tax *upon* public as opposed to private contractors had a proper equal protection basis as being a proper classification. In addition to that issue, the supremacy issue of the alleged discrimination against the Federal Government was also raised at its instance and decided adversely. Now to allow the Government to relitigate the same questions in a different forum is to fully negate the effect of the decisions cited herein.

Finally, the majority decision also discusses the issue of whether or not classification between public and private contractors is permissible. Although the opinion states that reaching such a decision is not necessary to their disposition, the opinion then goes on to rule that the grounds relied upon to support such a classification are in fact improper for Fourteenth Amendment classification, and the Act is therefore unconstitutional. There is no question but what that specific question was presented to the Supreme Court of Montana by the Government, (J.S. App. 119) and cannot now be raised again in these proceedings.

As stated by Judge Kilkenny in his dissent, the Government should not be allowed to relitigate the issues previously decided in this matter.

> "At a minimum, therefore, the Federal Government is collaterally estopped from relitigating the issues that were tried in the states courts. Thus, even if the *England* rule does not apply, I would conclude that the doctrine of collateral estoppel applies and it precludes our consideration of the merits of the two substantive issues reached by the majority." J.S. App. p. 27.

The Government in its motion to affirm attempts to mitigate the effect of this Argument by making the assertion that because the Montana Supreme Court proceeded on the theory that the tax generated under the Act might result in a total washout, the doctrine of collateral estoppel does not apply. What the Government has admitted, is that it, as the real party in interest, had the issues litigated but because the reasoning of the Montana Supreme Court covered many arguments, the doctrine of collateral estoppel does not apply. The Government cannot be allowed to relitigate issues raised and presented on their behalf and at their behest in a separate forum in the hope of obtaining a more desired result. Appellant urges this Court to accept the reasoning of Judge Kilkenney as stated above, and rule that the two substantive issues have been previously raised and the Government is therefore precluded from relitigating them at this time.

CONCLUSION

The Lower Court has misconstrued and misapplied *Phillips Chemical* and *Fresno County* rules. It has hopelessly garbled for the states the critical issue of whether "discrimination" is solely an equal protection concept, a Supremacy Clause concept, *or both.* In testing for equal protection discrimination, the Lower Court refused to apply established rules of *Madden.* It has refused to recognize the applicability of *England* or the basic rules of collateral estoppel.

The Lower Court decision sounds in concepts abandoned by the Court at the times of the decisions of *Dravo, King & Boozer* and more recently, *Detroit.* The Lower Court would have the "practical" application of *M'Culloch,* as approved by the Congress in *Boyd,* wholly abandoned.

The Act was not conceived as a scheme to bilk the Federal Government. It is a dignified attempt by Montana to meet the needs of its citizens as to tax collection and revenue raising. It in no sense impedes the Federal Government in the discharge of its functions within the concept of *Dravo, et al.* The Act is constitutional and the judgment of the Lower Court majority should be reversed, the constitutionality of the Act upheld, and the litigation dismissed.

Respectfully submitted,

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